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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1929.

No. 42

INTERNATIONAL SHOE COMPANY, PETITIONER,

vs.

FEDERAL TRADE COMMISSION.

REPLY BRIEF OF THE INTERNATIONAL SHOE COMPANY TO THE BRIEF OF THE FEDERAL TRADE COMMISSION, FILED NOVEMBER 26, 1929.

CHARLES NAGEL,
FRANK Y. GLADNEY,
R. E. BLAKE,
JAMES D. WILLIAMSON,
Counsel for International Shoe Company.

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In Explanation of the Surplus and Deficit Figures Shown in the Printed Record.

Petitioner desires to call the attention of the Court to the record as printed in this case. In the balance-sheets, which were adduced in evidence in the trial of the case, deficits were shown by figures in red. In the printing of the record this was abandoned and the figures were printed in black and, in order that the

Court may not confuse surplus and deficit figures, we will call the Court's attention thereto.

On page 646 of the record appears the report of the treasurer to the board of directors, covering nine months' operations, from May 30, 1920, to February 28, 1921. This shows operating losses for the period of $1,958,305.48. The figures should be in red. This report shows an undivided surplus May 30, 1920, of $3,888,440.73, and the surplus remaining after these losses and the payment of dividends of $644,090.75 was $1,286.044.50. This is confirmed by balance-sheet (R. 645).

On page 657 (top) of the record, balance-sheet of May 31, 1921, shows surplus, printed in italics, $4,382,-136.70. This should have been printed in red, because it is a deficit of $4,382,136.70 and not a surplus.

The balance-sheet of April 30, 1921, appearing at page 613, shows a deficit of $3,425,217.33. The figures should have been in red. In the balance-sheet of November 30, 1921 (R. 658, top), the deficit of $9,103,-076.59 should have been printed in red.

Reply Brief.

We desire to call the Court's attention to the contentions of the Commission upon which they base solvency and ability of the McElwain Company to continue in business. The Commission, at pages 8 and 9 of its brief, calls attention to Mr. McElwain's letter of April 13, 1921 (R. 641-645, inclusive), wherein Mr. McElwain states that the debts of the corporation were

at peak on February 28 and would be materially reduced on May 31st, and advising the tide had turned in the affairs of the McElwain Company and that its production would increase from then on. Mr. McElwain's hopeful outlook prior to the trade was contrary to the result of actual operation as shown by the record. The indebtedness of the corporation in February was $17,330,596.89 (balance-sheet, R. 645). On May 31, 1921, as disclosed by its balance-sheet, at page 657 (top), the indebtedness of the corporation was $15,880,901.42, showing that in that period of time its indebtedness had been decreased $1,449,695.47. The question, however, is at what cost this indebtedness had been decreased. On February 28, 1921, the balance-sheet (R. 645) reflected a surplus of $1,286.044.50. On May 31, 1921, the balance-sheet (R. 657, top) showed a deficit of $4,382,136.70, or a difference between those dates of $5,668,181.20. In other words, it had taken in excess of five and a half million dollars of assets to liquidate less than a million and a half dollars of indebtedness.

In November, 1921, the liabilities were $13,701,494.37, which was a reduction as between February 28 and November 30 of $3,629,102.52. At that time there was a deficit, as shown by the balance-sheet (R. 658, top), of $9,103,076.59. This loss wiped out its surplus of $1,286,044.50, as shown by its balance-sheet of February 28 and showed that it had been necessary to use $10,389,121.09 of assets in retiring $3,629,102.52 of liabilities. This same balance-sheet further showed that the corporation then had total current working, or

quick, assets of $12,735,599.14 (R. 657) with which to pay $13,701,494.37 (R. 658, top). This was impossible.

These balance-sheets and these figures confirm the testimony of the witnesses in this case that the McElwain Company was facing insolvency and its executives knew it. Mr. King, vice-president and financial man of the company at the time of the transaction (R. 292), testified that it was the feeling of the executives of the company that it was rapidly going on the rocks. At page 294 he testified:

> "Q. Faced with this situation, what did the executives of the McElwain Company do?"
>
> "A. They considered all possible alternatives for saving the company from receivership and liquidation; a study was made of the possible alternatives; only one alternative seemed to offer any hope of success." * * * "That was to negotiate a sale of the company to the International Shoe Company," etc.

He further testified (R. 295) the directors at first did not authorize such negotiations, but when the recommendation was renewed with urgency and it was approved and "we immediately opened negotiations with the International Shoe Company, within an hour after the approval of the directors."

He further testified, that after authorization such negotiations were opened on April 8, 1921 (R. 297).

The question of solvency is further suggested in the brief of the Federal Trade Commission by reason of the fact that the International Shoe Company paid $9,600,000 (which was the net value of assets as shown

by balance-sheet) for the three classes of stock of the McElwain Company. The record shows (p. 299, testimony of Stanley King): "I offered, for McElwain and myself, to turn over our securities without return, and said we thought the other directors would agree to follow us, and suggested that the common stock be not considered in the transaction. Mr. Rand was unwilling to consider that proposal on the ground it would break the morale of the eastern organization, and a proposal was worked out, which was submitted, which was approximately 80 per cent for the McElwain first preferred; 80 per cent for the second preferred, and 60 per cent for the common." This was subsequently changed to 82½ per cent for the first preferred, 75 per cent for the second preferred, and 50 per cent for the common; the aggregate was $9,600,000.00, the value of the assets. The purpose of the application of the purchase price to the acquisition of the stocks, as the record shows, was in order to preserve the morale of the executives and operatives of the McElwain Company so that the International Shoe Company would acquire operating factories. The record also shows, and the Federal Trade Commission found, that the International Shoe Company, by reason of its inability to fill orders which it had on its books, was needing new shoe factories, and the record also shows that this was the primary purpose for the acquisition of the McElwain properties. The factories to the McElwain Company in its then condition were worthless, but to

the International Shoe Company, with its inability to fill orders, were most valuable.

The Commission in its brief, at page 25, says:

> "During the first nine months of its 1921 fiscal year, on an average capitalization of $13,130,350 (R. 645-656). The McElwain Company paid dividends of $644,090.75 (R. 646) or at an annual rate of over 6½ per cent."

However, the dividends were not paid out of earnings made in the fiscal year of 1921. Such dividends (as R. 646 clearly shows) were paid out of surplus in face of an operating loss of $1,958,305.48 for the period. In the letter to stockholders written May 24, 1921, President McElwain said (R. 578): "We find losses for the current year (*i. e.*, 1921) of $6,472,000," which is at an annual rate of about 49 per cent on the capitalization mentioned.

Mr. McElwain's letter to preferred stockholders urging them to sell their stock to International Shoe Company (R. 578-582) is in effect a confession of insolvency and inability of the McElwain Company to continue in business.

The fact that Lee Higginson and Company recommended to the first preferred stockholders the sale of their stock at 82½ is conclusive that in their judgment the McElwain Company could not continue in the shoe business, and the fact that the first preferred stockholders accepted such recommendation and sold at 82½ is conclusive that in their judgment they would have been worse off by liquidation.

A copy of this brief has been duly served on counsel for the Federal Trade Commission.

Respectfully submitted,

CHARLES NAGEL,
FRANK Y. GLADNEY,
R. E. BLAKE,
JAMES D. WILLIAMSON,
Counsel for International Shoe Company.